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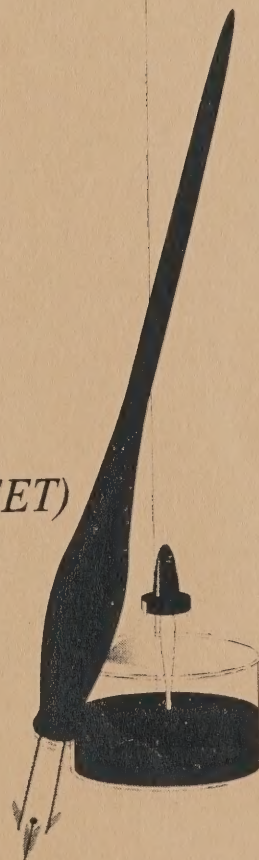
UNDERSTANDING TRADE LIBERALIZATION


by

Robert T. Stranks

Trade and Economic Analysis (EET)

(December 1998)





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*Department of Foreign Affairs
and International Trade*

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Understanding Trade Liberalization

This Commentary is intended to provide a short, clear overview of trade liberalization.¹ It consists of seven sections: The Rationale for Trade and Liberalization; What is Liberalization; Assessing Liberalization, Trade and Policy Coherence; Trade and Adjustment; Trade and the Environment; and Liberalization, Governance, and National Sovereignty. Each of these sections is designed to contribute to a better understanding of the particular issue addressed. As the reader progresses through the sections, it is hoped that the linkages between the issues, and the complexity of conceptualizing and assessing how liberalization impacts upon our lives, will become more fully appreciated.

The Rationale for Trade and Liberalization

The economic benefits of trade and of trade liberalization are widely recognized. By improving the allocation of factors of production, trade is an important contributor to economic welfare.² Trade allows economies to move beyond domestic production possibilities and constraints, and in so doing to provide a higher standard of living than would otherwise be the case.

The benefits of trade can be illustrated with an intuitive example. Consider two economies: Korea and Indonesia. Korea has no domestic oil production, and requires imported oil from Indonesia, or from other oil producers, to sustain its economic activities. Without this oil, the standard of living in Korea would fall. Conversely, Indonesia demands a range of consumer and capital goods not produced domestically, thus requiring imported goods from Korea, or from other goods producers. Without these goods, the standard of living in Indonesia would fall. Trade thus is beneficial for both of these countries.

Another way of understanding trade is to think of it as a technology for the production

¹This Commentary is based on a study prepared by the author for the APEC Economic Committee. See APEC Economic Committee Report, *The Impact of Liberalisation: Communicating with APEC Communities*, Singapore: APEC, November 1998.

²It should be noted that the logic for international trade and for domestic trade are the same, i.e., division of labour and specialization. This logic may also be applied to individuals and trade among individuals. Without trade, each individual would have to be self-sufficient, and consequently would have an extremely low living standard and short life span.

of goods.³ Let us say there are two technologies for the production of cars in Canada. The first technology involves the physical production of cars in factories in the province of Ontario. The second technology involves growing wheat in the province of Saskatchewan and subsequently exporting this wheat to Japan in exchange for cars produced in Japanese factories. While the two technologies differ with respect to inputs used, the final result is the same: Canada has the cars. Consequently, whether Canada should use the first or second technology should depend on which one enables Canada to get the most cars (or to get the same number of cars with the least resources). Trade is like the discovery of a new technology that makes workers more productive.

The reduction or elimination of barriers to trade between or amongst countries encourages firms to produce and trade goods and services in which they have a comparative advantage. Economies will concentrate on goods and services that they produce efficiently, and trade these goods and services for what they produce less efficiently.⁴

Trade liberalization allows for the greater exploitation of economies of scale. By allowing domestic producers greater market access opportunities, the freer market conditions allow firms to undertake greater specialized production runs that reduce the unit costs of production. For countries with small domestic markets, economies of scale may be extremely important. Economies of scale and specialization in specific product lines also explain why two or more countries may all produce and import and export a particular good, such as shoes. Each producer can have a specific market niche. This specialization in production, and the resulting increase in intra-industry trade (both imports and exports), however, implies change for the domestic industry.

Trade liberalization also increases competition, in both the foreign and domestic markets. This implies that firms will need to respond faster to changing market conditions. Greater competition is likely to provide an incentive for firms to increase their economic performance through cost-saving innovations and to enhance the quality of their products.

³This example is taken from Marc. T. Law and Fazil Mihlar, Debunking the Myths: A Review of the Canada-US Free Trade Agreement and the North American Free Trade Agreement, Public Policy Sources, no. 11, The Fraser Institute, (1998). This approach to understanding trade is taken from James Ingram, International Economic Problems, (New York: John Wiley, 1966).

⁴The gains from trade depend on the pattern of comparative, not absolute, advantage. Even if a Country A can produce everything more efficiently than its trading partner (absolute advantage) it will have an incentive to trade. This is because of the fact that Country A can produce certain things more efficiently than others, leaving room for Country B to produce those products that it can produce relatively more efficiently. Thus both countries have a comparative advantage in producing some good.

More competition also leads to lower prices for consumers.

Finally, trade liberalization undertaken in a bilateral or multilateral context and which establishes clear trading rules will reduce uncertainty. Without such rules, a country may face unilateral, often damaging, actions from its trade partners. The reduction of uncertainty, while providing more stable access, will also allow firms to make more informed business decisions.

In short, an economy under autarky (i.e., one with no or with limited international trade) that must domestically produce all that it consumes, forfeits the economic gains (and social benefits) that are realized through international trade. Trade, and the liberalization to make trade possible, is a positive proposition.

In an article addressing some myths and misconceptions of trade, Paul Krugman highlighted and summarized six points to consider in understanding trade:⁵

- International trade is an economic activity like any other and can be thought of as a production process that transforms exports into imports;
- Imports, not exports, are the purpose of trade. A country benefits from trade because of the ability to import the products it wants. Exports are not an objective in and of themselves: the need to export is a burden that must be borne in order to pay the suppliers of imports;
- High productivity is beneficial, not because it helps a country compete with other countries, but because it lets a country produce, and therefore consume, more. This is true in a closed economy, and it is no more nor less true in an open economy;
- Too much emphasis is put on "high-value" sectors. Trade allows all countries to benefit, not only those specializing in the "high-value" sectors;
- Employment is a broad macroeconomic issue, with policies, such as tariffs, having little net effect. Trade policy should not be debated in terms of "phony numbers about jobs created or lost"; and,
- Government support of a specific industry may help that industry compete against

⁵Paul R. Krugman, "What Do Undergrads Need To Know About Trade?", American Economic Review, 83(May 1993).

foreigners, but it also takes resources away from other domestic industries. International trade does not change the fact that government cannot favour one domestic industry except at the expense of others.

What is Liberalization

To understand the benefits of trade, an understanding of the characteristics and institutional context of trade liberalization is required. The focus here will be on the multilateral trading system. The most visible trade barrier is the tariff, but trade liberalization is much more than negotiations on tariff rates. Within a multilateral context, first with the General Agreement on Tariffs and Trade (GATT) and then with the World Trade Organization (WTO), tariffs have fallen considerably over the past 50 years.⁶ But other measures aside from tariffs, such as subsidies and government procurement practices, also affect trade, and have long been recognized as often having trade distorting effects and requiring multilateral discipline.

The Uruguay Round of GATT negotiations, which resulted in the establishment of the WTO, further expanded the multilateral trade rule framework to include such issues as trade-related investment measures (TRIMS), trade-related intellectual property (TRIPS), and trade in services. Services, which cover a wide range of economic activities, such as banking, transportation, and telecommunications, are an important component of the economy and trade. In sum, while the details of the WTO's General Agreement for Trade in Services (GATS) are complex, the agreement substantially broadened the economic activities subject to multilateral rules.

Dispute settlement is another important aspect of trade liberalization. Without an

⁶The General Agreement on Tariffs and Trade (GATT), opened for signature 30 October 1947. The GATT, containing tariff concessions and a set of rules preventing certain trade restrictions, was signed by 23 countries. On January 1, 1948, the Agreement was implemented. Since its establishment, there have been eight Rounds of negotiations in the GATT. The seventh Round, which began in 1973, is referred to as the Tokyo Round, and the eighth Round, which lasted from 1986 to 1994, as the Uruguay Round. J.H. Jackson, The World Trading System, (Cambridge, Mass.: MIT Press, 1991) provides an insightful overview of the rights and obligations set out in the GATT.

The World Trade Organization, which embodies the GATT, was established by the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations. It was implemented January 1, 1995. The WTO currently has over 130 members. For a history of the Uruguay Round negotiations leading up to the establishment of the WTO, see John Croome, Reshaping the World Trading System: A History of the Uruguay Round, (Geneva: World Trade Organization, 1995).

effective dispute settlement mechanism, trade liberalization measures become less secure and predictable for producers. Yet the dispute settlement mechanism, while significantly different in nature than a tariff, also influences a firm's production decisions and how it approaches international trade. In considering the benefits of trade liberalization, capturing the benefits of dispute settlement and rules for such practices as anti-dumping measures, is extremely difficult. The literature generally recognizes that a predictable and transparent global market place with an effective dispute settlement mechanism is beneficial to importers, exporters, and consumers.

Multilateral discipline through rules and dispute settlement procedures is particularly important for smaller economies that do not have the economic power to resolve conflicts through bilateral means. This is a useful perspective, as some members of the public consider the multilateral trading system to be only in the interest of the largest economies. On the contrary, while of interest to all economies, smaller economies stand to lose the most from its deterioration.

Trade liberalization is also intricately tied to the trade blurring or "new" trade-linking agenda. There is no consensus as to what the scope of these linkages, or "new" trade issues, are or should be.⁷ As a practical matter, the WTO has not turned a blind eye to the "new" trade issues. While the WTO at present does not have a mandate to negotiate such issues, its Members see a need to more fully understand the relationships between trade and other policy areas. Soon after its creation in 1995, the WTO formally established a Committee on Trade and the Environment; at its Singapore Ministerial Conference in 1996, the WTO agreed to create Working Groups on the relationship between trade and investment, and trade and competition policy linkages.⁸

Assessing Liberalization

There is a substantial amount of literature on trade theory, trade policy, and the costs of protection and the benefits of liberalization. Three particularly readable and insightful documents addressing liberalization have been issued by the World Bank, the International

⁷Current U.S. Trade Representative Charlene Barshefsky recently highlighted competition law and restrictive business practices as barriers to trade. The USTR observed that with respect to Japan "markets remain largely closed, opaque and driven more by informal cliques than by laws, rules and contracts." She also raised the issue of bribery and corruption and called for the WTO to "begin tackling head on bribery and corruption." "Barshefsky Calls on WTO To Reduce Structural Barriers To Trade," Inside U.S. Trade, 16, no. 15, (April 17, 1998), 15.

⁸An earlier GATT group, the GATT Group on Environmental Measures and International Trade, had been active since 1991.

Monetary Fund (IMF), and the Organization for Economic Co-operation and Development (OECD).⁹

The World Bank document considers liberalization from the perspective of the challenges it raises for workers in an integrating global economy. The document concludes that international trade generally benefits workers because:

- It gives firms access to much larger markets in which to sell their products; that is, global markets remove constraints imposed by domestic demand. In particular, it allows firms to specialize and to upgrade production on the basis of global demand;
- Increased openness to trade has been strongly associated with poverty reduction in most developing countries; and
- Trade allows workers access to consumption goods where they are cheapest, and permits firms to purchase capital goods with the latest technologies. The rapid industrialization in East Asia has been built to a large extent on imports of Western technologies and machinery.

The document also highlights that liberalization involves change and policy responses:

- Economies must undergo often painful adjustment if they are to reap the benefits of trade, especially if their economies have been heavily protected. Changes in the pattern of trade bring about social transformations, negatively affecting the workers who lack the flexibility or the skills to leave sectors previously supported by trade barriers;
- Since society as a whole gains, the challenge for policymakers is to facilitate transition to freer trade by upgrading the skills of the labour force, and to avoid protection.

The IMF document takes a growth strategy approach to its analysis of liberalization, and reaches similar conclusions:

- With respect to developing countries, the performance of the outward-oriented economies has been superior to that of the inward-oriented economies, where tariff and

⁹These are Chapter 8 of the World Bank, World Development Report 1995: Workers in an Integrating World, (Washington, D.C.: The World Bank, 1995); Chapter VI of the International Monetary Fund, World Economic Outlook, (Washington: IMF, May 1993); and, OECD, Open Markets Matter: The Benefits of Trade and Investment Liberalisation, (Paris: OECD, 1998).

non-tariff barriers have been high and where there has been a bias against exports in favour of import substitution;¹⁰

- The costs of trade restrictions and isolation from the competitive forces of world markets are amply illustrated by the former centrally-planned economies. Decades of central planning, including managed trade, resulted in unproductive investments and an obsolete capital stock; and
- Most developed countries have in place complex policies to protect domestic agriculture. These policies are extremely costly, and influence production, employment, consumption, and trade.

The OECD study, Open Markets Matter: The Benefits of Trade and Investment Liberalisation, takes a multidisciplinary approach and synthesizes a large amount of work undertaken by that organization, and elsewhere, particularly over the past few years. The core message of the study is that on balance trade and investment liberalization in the long-term is beneficial to society. The study gives a balanced assessment of the strengths and weaknesses of trade, including drawing attention to the fallacy of "exports are good and imports are bad" argument. Trade liberalization influences both imports and exports. Access to low cost imports, for example, plays an important role in enhancing consumers' well being, as well as allowing domestic firms to have access to competitively priced inputs.¹¹

Trade and Policy Coherence

While liberalization of trade is an important component in improving living standards, it is only a component; a coherent set of policies is required to achieve a durable improvement in living standards. This is an important conclusion as it stresses that an overall assessment of the costs and benefits of liberalization are dependent upon choices made in other policy areas.

¹⁰The IMF document classifies developing countries into four categories according to the orientation of their trade strategy during the 1974-1992 period: (1) strongly outward-oriented; (2) moderately outward-oriented; (3) moderately inward-oriented; and (4) strongly inward-oriented.

¹¹The Institute for International Economics has published a number of books that explore the cost of protection in a number of countries. Hufbauer has summarized the results of this research on the cost of protection. A major conclusion is that there are considerable costs associated with maintaining production and employment in protected sectors, and that for every job "saved" consumers pay a significant price, sometimes in the hundreds of thousands of US dollars. For a survey of studies conducted by the Institute for International Economics as well as by others on a number of countries see Gary C. Hufbauer C. "Surveying the Costs of Protection: A Partial Equilibrium Approach" ch. 2 in The World Trading System: Challenges Ahead, ed. Jeffrey Schott, (Washington: Institute for International Economics, 1996).

Trade, as well as other international economic activities, are linked with a complex mix of "domestic" economic, and even social, policies. How the opportunities of liberalization are seized and benefited from, in large part, is dependent upon domestic policy decisions and how firms respond to these decisions. These policy links include the effect on trade of domestic policies that affect human resource development, economic infrastructure, environmental stewardship, adjustment to technology, and promotion of innovation.¹² The intersection of international trade with traditionally domestic policy areas raises increasingly sensitive questions on policy coherence. This is particularly relevant and of broad public interest in respect to issues surrounding structural adjustment, such as labour market policies. Public interest is also high in regard to the linkages between liberalization and the environment.

Trade liberalization, by opening markets to increased competition and accentuating the on-going structural adjustment process, makes the costs and benefits of domestic policy choices more transparent. Poor policy choices, however, with or without trade, have a cost. Turner emphasised this point with respect to Europe, by observing that Europe's unemployment problem is not due to a failure of competitiveness in the face of a global challenge, but due to a failure of economic flexibility in the face of developments most of which would have occurred even if trade and capital flows were no more global than in the 1960s.¹³

Trade and Adjustment

Trade and trade liberalization by definition imply that the composition of production and of employment changes in the countries involved. This, however, in no way implies that trade is the singular or most important factor contributing to pressure for labour force adjustment. Labour markets are in constant flux. At any given time, different sections of the economy are growing or contracting at different rates. Nor should it be understood that changes in the labour force or pressure for change, from whatever source, are an adverse economic development.

¹²The nature of these links is not always clear or obvious. For example, bribery and corrupt business practices that distort competition and trade and investment is an issue. To this end, in an attempt to address corruption, in November 1997, the OECD members adopted the Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions. For an overview of the causes and consequences of corruption see Kimberly Ann Elliot, ed., Corruption and the Global Economy, (Washington, D.C.:Institute for International Economics, 1997).

¹³Adair Turner, "Globalization: Threat or Opportunity", speech delivered at the European Business School, March 25, 1998.

The economic benefits stemming from trade liberalization require adjustment, including labour market adjustment. The OECD has summarized the empirical results of a number of studies conducted on the employment effects of trade liberalization.¹⁴ It concluded that the net impact of trade liberalization on employment is in general small at the aggregate level of the overall economy. The labour adjustment required is also likely to be small with respect to changes occurring for other reasons, such as technological change or the emergence of new products. The OECD report concluded that "the number of additional workers who would have to change jobs as a result of trade liberalization would be likely to be only a fraction of the normal rate of labour turnover, particularly if the trade liberalization were spread over a number of years."¹⁵ The central conclusion of the OECD work, i.e., that the role of liberalization in labour market performance is much smaller than many believe, has also been reached by others.¹⁶

Employment effects on specific sectors or firms could, of course, be more pronounced. The OECD also noted that social "problems may arise if the job displacements tend to concentrate on groups of the labour force who are disadvantaged anyway, e.g., unskilled labour."¹⁷ From a political perspective, highly visible and concentrated sectoral job losses may not offset the more diffused job gains.

Trade liberalization implies that short-term structural adjustment is necessary for longer-term prosperity. This creates challenges for other policy areas, and raises the question of how governments can most effectively intervene to facilitate adjustment by firms and individuals to new conditions caused by change, including trade. It also raises the question about whether those experiencing pressure to adjust from foreign sources should be treated any differently than those facing pressure from domestic sources.

Analysts have noted that the type of trade and the type of structural adjustment pressures that occur can influence the public's perception of whether or not trade is

¹⁴OECD, Trade and Employment, C(89)42, (1989).

¹⁵OECD, Trade and Employment, C(89)42, Annex Summary Report, (1989), 4.

¹⁶Lustig puts the concern and misperception of the role of trade into stark policy terms; "identifying ways to address the rising economic polarization and declining living standards for the less-skilled in the United States deserves greater attention on the part of policy makers. Otherwise, many lawmakers are likely to continue focusing on the wrong instrument - that is, trade protection - to combat it." Nora C. Lustig, "NAFTA: Setting the Record Straight, The World Economy, 20, no.5 (August 1997), 606.

¹⁷OECD, Trade and Employment, C(89)42, (1989), 29.

beneficial.¹⁸ Trade amongst OECD countries can be characterized as intra-industry, i.e., trade in similar products. Adjustment in this case involves shifting employment and other factors of production within a firm to new production lines, or shifts within an industry. There is no major deindustrialization of a sector, and the foreign competitors are not often regarded by the public as low-cost competitors with major differences in factor endowments.

Inter-industry trade, the trade of different products from different industries in different countries, is often associated with OECD member country trade with developing countries. This type of trade can require that adjustment be made by an entire industry. The entire workforce of an industry could face change due to new, low-cost producers. This type of industry adjustment, which is much more visible to the media, prompts demands from the industry and employees to remove the threat from foreign producers (i.e., demands for protection).

Nevertheless, protectionism is not a viable, long-term strategy for improving living standards.¹⁹ Attempting to maintain a status quo industrial structure in the face of global change is a short-sighted strategy. Although high tariffs and levels of protection insulate domestic producers from competition, over time, as international competitors increase productivity, the gap between domestic and foreign producers grows. So, too, will the gap in living standards. Also, the longer protection lasts, the more difficult it becomes politically to liberalize as the adjustment shock to domestic producers will be that much greater. Moreover, even though adjustment is a "cost" in the short-run, it is a "benefit" in the longer-run. The final word goes to Lustig, who summarizes this view with:

"It may be important to note that even if trade protection may bring small, short-term relief for unskilled workers, this will be at the expense of lower growth and living standards - including those of less-skilled workers - in the future. A more fruitful alternative would be to pursue policies designed to upgrade the education and skills of the working population."²⁰

¹⁸Niels Thygesen, Yutaka Kosai, and Robert Z. Lawrence, Globalization and Trilateral Labor Markets: Evidence and Implications, A Report to the Trilateral Commission, 49, (December, 1996).

¹⁹The OECD compiled a significant body of evidence on the cost of protection in a 1985 study entitled Costs and Benefits of Protection.

²⁰Nora C. Lustig, "NAFTA: Setting the Record Straight, The World Economy, 20, no.5, (August 1997), 610.

Trade and the Environment

The public has expressed some anxiety with respect to potentially negative environmental effects of trade and trade liberalization, particularly that through adverse effects on the environment, trade may lower the overall quality of life. Addressing this concern in an objective manner may well be key to maintaining public support for an open trading system and building support for a strengthened and more open multilateral trading system, including investment. Liberalization and a high quality environment share the common objective of improving living standards. To achieve this objective, cooperation is required because of the interdependence of countries on both of these issues. While there is a literature on the trade and environment interface, it is fair to say a good deal more analytical work is required to develop a more sound understanding of the relationship.²¹

When assessing the impact of trade on the environment, environmental policy must also be considered.²² Trade and investment are not necessarily adverse for the environment. When environmental policies are set at appropriate levels, available evidence suggests that trade and investment activities usually will have a positive impact on the environment. When environmental policies are not set at appropriate levels, trade and investment activities can aggravate environmental problems. A significant factor is the nature of the environmental policy itself.²³

²¹See Kym Anderson and Richard Blackhurst, eds., The Greening of World Trade Issues, (Toronto: Harvester Wheatsheaf, 1992); Daniel C. Esty, Greening the GATT: Trade, Environment and the Future, (Washington, D.C.: Institute for International Economics, 1994); Jagdish Bhagwati and Robert Hudec, eds., Fair Trade and Harmonization: Prerequisites For Free Trade?, 2 volumes, (Cambridge: MIT Press, 1996); OECD, The Environmental Effects of Trade, (Paris: OECD, 1994).

²²Analytical work by the WTO has concluded "it is generally accepted that in order for these benefits to be realized, and for trade-induced growth to be sustainable, appropriate environmental policies determined at the national level need to be put in place." This arises as the most significant trade liberalization -environmental linkages pass indirectly through effects on levels and patterns of production and consumption. WTO Committee on Trade and Environment, Environmental Benefits of Removing Trade Restrictions and Distortions, Note by the Secretariat, WT/CTE/W/97, (November 1997).

²³See John Beghin and Michel Potier, "Effects of Trade Liberalisation on the Environment in the Manufacturing Sector," The World Economy, 20, no. 4, (July 1997), 437. They conclude that: "A major policy implication that emerges from the study is the need for coordination of environmental policies and trade liberalisation reforms. Although free trade can be beneficial to the environment in the case of formerly protected and inefficient (pollution-intensive) industries, it is difficult to determine a priori the environmental implication of the post-liberalisation division of labour in manufacturing activities. Economic theory alone cannot predict trade and production patterns in dirty activities in a world of many countries, commodities, and factors of production. Hence, the presence of environmental policies is instrumental in protecting the environment."

If prices for products are distorted, such as through subsidies, trade and trade liberalization may have an adverse environmental impact. This, however, does not imply that trade or trade liberalization should be avoided, nor that trade measures are the most appropriate response to subsidization of resource use.²⁴ Rather, appropriate domestic policies are required to avoid negative environmental impacts. In particular, subsidies to producers or consumers of energy and agricultural products often contribute to trade distortions as well as having negative environmental implications.

Moreover, trade and investment in environmentally-preferred products and services are important mechanisms through which liberalization can benefit the environment. The key to this relationship is technology, and what products embodying the latest technologies, and services providing technologies, imply for the environment. International diffusion of technology and the use of efficient (resource-saving) products can be facilitated by freer trade and liberal investment policies.²⁵ Technology and innovation issues also imply that the links between trade and the environment need to be considered in a long-run framework.

Liberalization, Governance, and National Sovereignty

Liberalization, and rules setting out rights and obligations, has evoked fears on the part of a number of individuals and organizations that national policy autonomy, or even sovereignty, has been gradually undermined to the detriment of society. The OECD describes this concern as "the perception that increased global competition, underpinned by global trade and investment agreements, is eroding the capacity of governments to exercise national 'regulatory' sovereignty; that is, to independently determine national policy objectives and implement regulatory decisions on both economic and social issues."²⁶ Yet constraints on independent action, with no regard to international repercussions, should not be considered as an inevitably negative development.

Constraints on governments may be positive as they add predictability to the conduct of

²⁴For a discussion on some of the difficulties of using countervailing duties in response to "environmental subsidies" see Robert T. Stranks, Pandora's Box?: Countervailing Duties and the Environment, (Ottawa: Department of Foreign Affairs and International Trade, October, 1994).

²⁵John Beghin and Michel Potier, "Effects of Trade Liberalisation on the Environment in the Manufacturing Sector," The World Economy, 20, no.4, (July 1997), 437.

²⁶Organization for Economic Cooperation and Development, Open Markets Matter: The Benefits of Trade and Investment Liberalization, (Paris: OECD, 1998), 76.

international relations and allow for a world-wide trade regime to function.²⁷ In other words, the WTO is not a cost to be endured. Rather it is a benefit to be actively supported.²⁸ For smaller economies which would otherwise be subjected to discriminatory trade policy actions from larger economies, this is particularly important. International commitments may also act as a counterweight to protectionist forces and short-term political opportunism.²⁹ To the extent that there is a dilution of unrestrained sovereignty, it can be offset through the use of influence by national governments in international organizations and the establishment of international rules. Globalization, and the international governance that has accompanied it, should not be seen as the death of the nation state nor as the reckless throwing open of vulnerable domestic economies to chaotic forces.

Trade liberalization and trade governance are manifested in internationally-negotiated rights and obligations. Governance is about giving direction, but it is also about providing an analytical framework for issue formulation. In an international context, with the recognition that new policy tools and international cooperation will be required, Renato Ruggiero, the current Director-General of the WTO, has characterized this governance challenge as the risks and benefits of "Inventing the Future".³⁰

Does trade liberalization, or globalization more generally, require a dismantling of national social welfare mechanisms and a race toward minimal government? The answer to this is not likely. The fear that governments are unable, or have been unable, to implement regulatory decisions on social issues is not supported by the evidence. Krugman and Lawrence have emphasized that governments retain substantial autonomy in regulating their economies, designing their social policies, and maintaining institutions that differ from those

²⁷This is not specific to trade liberalization. An important aspect of sustainable development and protection of the global commons is the recognition of the need for joint and cooperative measures that may restrain national action.

²⁸It should also be recalled that the WTO is not a supernational organization, and that it only administers what its Members have agreed to.

²⁹This benefit is sometimes called the "Ulysses effect" where international rights and obligations help prevent governments from being tempted to favour interest groups at the expense of the economy as a whole. Kym Anderson, "50 Years: Looking Back, Looking Forward", paper presented at The Graduate Institute of International Studies and World Trade Organization, Geneva, 30 April, 1998

³⁰Renato Ruggiero, "Charting the Trade Routes of the Future: Towards a Borderless Economy", speech given at the International Industrial Conference, San Francisco, 29 September, 1997

of their trading partners.³¹

With liberalization in the broad self-interest of economies, and not detrimental to the exercise of national sovereignty, why is it that countries maintain and at times strengthen restrictions? There appears to be two explanations. First, understanding trade and investment and the links with the domestic economy is not an easy or straight-forward task. Consequently, the public may be misinformed, and this is likely to translate into less political support for liberalization than would otherwise be the case.

Secondly, there is a political economy explanation for protectionism.³² This literature draws attention to the fact that some firms and individuals gain, sometimes quite considerably, from protected markets. Protection influences the distribution of income, with the income gains being concentrated in the few who actively support political regimes that are willing to allow the protection to continue or even increase. The losses are spread over a large section of the public, and on a per capita basis are often not large enough to stimulate collective and coordinated action to act as a political counterweight to those seeking protection.

Conclusions

It is hoped that this short paper has contributed to developing a balanced overall view of trade liberalization. Liberalization is not the root cause of the world's economic ills, nor is it the panacea. The literature highlights three key interrelated themes. First, and foremost, on balance in the long-term trade liberalization is beneficial to society. Liberalization promotes efficiency, encourages innovation, raises incomes, and gives consumers a greater choice of goods. Liberalization is a means to an end, rather than an end in itself.

A second major theme is that while liberalization of trade is an important component in improving living standards, it does not stand alone. Liberalization is only a component; a coherent set of policies is required to achieve a durable improvement in living standards. This is important as it stresses that the cost and benefits of liberalization are dependent upon choices made in other policy areas. This factor is particularly relevant with respect to issues surrounding structural adjustment, such as labour market policies and sustainable

³¹Paul Krugman and Robert Lawrence, "Trade, Jobs, and Wages", The World Economy 21, no.4, (April 1994).

³²See Gene Grossman and Elhanan Helpman, "Protection for Sale", American Economic Review, 84, no. 4, (September 1994); Arye L. Hillman, The Political Economy of Protection, (New York: Harwood Academic, 1989); and Bernard Hoekman and Michel M. Kostecki, The Political Economy of the World Trading System: From GATT to WTO, (London and New York: Oxford University Press, 1995).

development.

Thirdly, short-term structural adjustment is necessary for longer-term prosperity. This fact creates challenges for other policy areas. Most importantly, there is a need to facilitate adjustment, and for the gains from liberalization to be as widely shared as possible. This requires policies to help, in particular, those most affected by adjustment.

The concerns about trade liberalization inducing social disintegration are not justified. Liberalization is not the main cause of income inequality. Rather, skill-biased technological change has increased demand for more skilled workers and reduced that of unskilled labour. Moreover, in the longer term, trade protection does not upgrade the skills of workers or contribute to a more flexible workforce, and this has its own negative social consequences. The appropriate policy response is to facilitate the adjustment of workers in increasingly knowledge-based economies, whatever the sources of change.

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